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C O N F I D E N T I A L SECTION 01 OF 02 KYIV 000017

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TAGS: EFIN EREL ETRD PGOV PINR UP XH  
SUBJECT: TYMOSHENKO UNABLE TO PRY OPEN NBU RESERVES

REF: KYIV 1981

Classified By: CDA James D. Pettit for Reasons 1.4 (b) and (d)

¶1. (C) Summary. Negotiations have stalled over the transfer of \$2 billion in National Bank of Ukraine (NBU) reserves to the state treasury, inhibiting Prime Minister Tymoshenko's government from getting ready cash to assist with Naftohaz's January 11 payment to Gazprom. Having lowered the NBU's net international reserve (NIR) target and allowed for the transfer, the IMF Board and its Kyiv resident representative have stepped back from any mediating role among Ukraine's authorities. While holding firm on the transfer of reserves, the NBU has proposed the sale of Naftohaz-held government bonds to commercial banks, though bankers say they have not heard of (nor would they necessarily be interested in) an impending sale of GOU debt. Analysts conclude that a deal between the GOU and NBU over the transfer of reserves may still be forthcoming or else a financial workaround will be found, as there is no interest within or outside Ukraine in a gas crisis redux. End summary.

IMF "DONE WHAT IT CAN DO"

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¶2. (C) IMF Kyiv-based resident representative Max Alier told us on January 5 that negotiations over the transfer of \$2 billion in liabilities to the IMF from the NBU to the GOU were continuing but "not going anywhere". Alier said he had not met with any of Ukraine's top authorities in recent days and was studiously avoiding a "mediating" role among the parties over the NBU's reserves.

¶3. (C) Alier said the IMF had already "done what it can do" for Ukraine before the upcoming presidential election. It had become "extremely clear" to the Fund that it could not intervene any further. Absent a consensus among Ukraine's authorities over the transfer of the reserves from the NBU to the GOU, Alier expected that the GOU and Naftohaz would be forced to reach out to commercial banks. He speculated that Naftohaz might test market appetite for a sale of GOU bonds, held by the state energy company since it was recapitalized by UAH 18.6 billion in July 2009 and another UAH 12 billion at the end of December 2009 (reftel). (Note: Naftohaz has used at least UAH 3.25 billion of the bonds to pay for gas previously. End note.)

¶4. (C) Alier felt certain that foreign banks had enough liquidity to purchase the bonds, though he admitted he had not spoken with bankers about whether they would be interested in the debt. An alternative mechanism would have public banks purchase the instruments below par value. In any case, IMF leadership was certain that no key stakeholders within or outside Ukraine wished to prompt a crisis in the

event of non-payment of Naftohaz's January 11 bill to Gazprom.

¶ 15. (C) Note: IMF Deputy Managing Director Lipsky had written a confidential memo to Prime Minister Tymoshenko, Deputy Prime Minister Nemyria, Acting Finance Minister Umanskiy, and NBU Governor Stelmakh on December 30 to inform them of the Board's decision to lower the end-2009 NIR target by \$2 billion to \$12.9 billion, per the GOU's request. Although the NBU had deemed this move "unnecessary", the IMF reasoned that the modification could increase flexibility to make external payments. End note.

NBU REJECTS TRANSFER OF RESERVES, GOU BOND PURCHASE

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¶ 16. (C) NBU Director for International Relations Sergiy Kruglyk told us on January 5 that the central bank could not transfer reserves to the GOU without a guarantee that the GOU would use the monies solely for external payments. Only the IMF could impose such a guarantee, Kruglyk said, since the GOU "doesn't care about gas -- only about making wage and pension payments." Furthermore, the NBU would not buy GOU bonds, as it had determined that it already held 500% more than the acceptable amount of GOU liabilities and needed to closely watch the overall money supply.

¶ 17. (C) There were two possible options remaining to help with the gas payment, according to the NBU. One would have the IMF recall a prior loan allocating monies to the NBU's reserves, with the IMF instead reissuing a new loan of the same amount to the GOU's treasury. Another option would be

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for Naftohaz or the GOU to sell bonds to commercial banks. There was UAH 20 billion in banking sector liquidity, according to Kruglyk, and Naftohaz only needed UAH 8 billion (roughly \$1 billion) to meet its upcoming obligations.  
(Note: Naftohaz Chairman Oleh Dubyna told the Ambassador on December 24 that Ukraine purchased approximately 4.2 billion cubic meters of gas in December. Based on that amount, the payment due on January 11 will be around \$874 million. End note.)

¶ 18. (C) Kruglyk noted that if either the GOU or Naftohaz had enough hryvnia resources available, the NBU would be willing to exchange local currency for dollars to meet external payments. The NBU would not comment on market appetite for GOU debt issued directly or sold by Naftohaz, though Kruglyk said Ukrainian authorities were in active negotiations with commercial banks today.

BANKS HEARING CRICKETS

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¶ 19. (C) However, a sample group of representatives from foreign-owned banks and domestic state-owned banks -- the two likeliest sources of available capital -- told us on January 5 that they had not been approached by the GOU or Naftohaz to buy bonds prior to the January 11 gas payment deadline. OTP board member Miklos Bebiak said that he had heard some rumors of the bond sale, but that he was not aware of any details. Dimitro Sologoub noted that Raiffeisen-Aval's traders had likewise not been contacted.

¶ 10. (C) Raiffeisen-Aval had concluded the NBU and GOU would continue their negotiations over the transfer of reserves until the last minute. It had also heard that, as a fallback plan, the NBU was working on a mechanism to directly credit Gazprom, effectively bypassing Naftohaz and the GOU treasury in order to prevent Tymoshenko from using the monies for social payments. In any case, Raiffeisen-Aval and other foreign-owned banks saw "no point" in buying more GOU liabilities, as they already had huge holdings.

¶ 11. (C) Anna Zakharova, Director of International Finance at

state-owned Rodovid Bank, said that most senior representatives she knew from fellow state-owned banks were away from Kyiv during the holiday week. She told us that Rodovid had not been approached by the GOU or Naftohaz. Even if it had been requested to urgently buy GOU securities, it would not have been in a position to make a large trade until the week of January 11.

COMMENT

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¶12. (C) The bank most likely to be arm-twisted into buying GOU debt is state-owned Oshchadbank, whose assets are already extraordinarily tied to Naftohaz. (Fitch recently indicated that Naftohaz takes up 53% of Oshchadbank's loan portfolio, roughly equivalent to 120% of the bank's capital.) However, because state-owned banks do not possess enough liquidity to help with the entirety of Naftohaz's outstanding obligations, NBU reserves or a loan from a Russian source will still be needed. Governor Stelmakh holds the aces and has upped the ante but, serving at the will of the President and in his final days in office, will be careful not to overplay his hand.

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